Viewing cable 09RIYADH903, SAUDI OPEC GOVERNOR PROVIDES CODEL TOUR D'HORIZON

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SUBJECT: SAUDI OPEC GOVERNOR PROVIDES CODEL TOUR D'HORIZON

Classified By: DCM David Rundell, reasons 1.4 (b) and (d).

¶1. (SBU) Summary and comment:  Congressman Alan Grayson
(D-FL) met OPEC governor for Saudi Arabia Dr. Majid Al-Moneef
with DCM June 29.  Moneef provided an unusually detailed tour
d'horizon of his views on the oil business and OPEC.  He
expressed satisfaction that the price of oil was moving back
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up towards the $70 - $80 range Saudi leaders say they consider fair, although he noted with mild amazement that the Kingdom's excess production capacity has risen from its longtime target of 1.5 - 2 million barrels of oil per day to around 4 million. Overall the U.S.-educated OPEC governor seemed confident but not complacent about the health of his country's most important economic sector. End summary and comment.

OPEC GOVERNOR BRIEFS CONGRESSMAN

¶2. (SBU) Congressman Alan Grayson introduced himself to Saudi OPEC governor Dr Majid Al-Moneef as a member of the House Financial Services Committee, saying he long had been interested in Saudi Arabia and energy and was pleased to visit the country as part of his first official visit abroad.

SAUDI ENERGY POLICY: MAINTAIN
EXCESS PRODUCTION CAPACITY

¶3. (SBU) Moneef said that the Kingdom was "important" not just because of its vast oil reserves and huge production but because of the ability it had demonstrated over many years to increase production capacity while international demand has grown. The Kingdom, he said, has been able to avoid political and technical problems that have hampered production in other oil producing countries, allowing it to provide needed increments when others could not.

¶4. (C) Moneef explained that the fundamental tenet of Saudi Arabia's energy policy for decades has been to maintain a 1.5 to 2 million barrels of oil per day (mbpd) excess production capacity. He said the Kingdom's excess production capacity today is approximately 4 mbpd, with current production around 8 mbpd. Comparing this large surplus to the country's average daily production in the 1980s, which he described as "around 5" mbpd revealed just how large this idle capacity is, and how expensive it is to maintain. Nevertheless, he explained, "We were able to use our spare capacity during the Iranian revolution, the Iran-Iraq war, the Iraq-Kuwait war, and the turmoil in Venezuela in 2003" to stabilize oil markets. He said the secret of Saudi success was to continue building and maintaining additional production capacity even when demand has fallen. He emphasized, "We don't mothball," and to the contrary, he said, Saudi Arabia is the "Federal Reserve of oil."

¶5. (C) Financial Services Committee Professional Staff Member Dennis Shaul asked how much of the current 4 mbpd excess production capacity was heavier grades of crude. Moneef replied that overall 65% of Saudi crude produced was Arab Light, and the country sought to maintain this ratio, even last year when it cut production relatively deeply. Only if it attempted to produce at levels approaching its maximum sustained production capacity would that ratio begin to shift significantly in the direction of heavier grades of crude, Moneef said. He concluded that although current Saudi policy means the Kingdom is stuck with 4 mbpd excess production capacity "slack,... at least we have it."

OPEC DECISIONMAKING

¶6. (SBU) Asked if it was harder for OPEC to agree on production increases or decreases, Moneef explained that most OPEC members were producing at or near their marginal capacity, and Saudi Arabia was one of the few countries that still had flexibility on production decisions. Consequently, the Kingdom had increased production from 2002 to 2008 while other countries had been unable to do so. Nevertheless, decreasing production was hard for most other OPEC members, since they did not have the Kingdom's fiscal discipline or financial freedom to reduce oil sales voluntarily. Moneef said most OPEC members were willing to increase production, "even Angola and Libya," but in general terms, investment in these countries has been insufficient.

¶7. (C) Asked which countries were hardliners within OPEC (in terms of opposing production increases), Moneef replied that this had changed over time; however, in addition to Iran and Venezuela, which he said both were "happy to see oil at $100," Libya increasingly was joining the hardliners' camp as a vocal opponent of proposals to increase production. Saudi Arabia, he claimed, frequently had to remind other members that the agreement that founded OPEC set an objective to keep the oil market balanced, and not to maximize prices.

¶8. (C) When asked about quotas, Moneef replied that OPEC meetings result in decisions on production levels but do not impose quotas. He told the Congressman that OPEC identified production targets for its members by studying world demand and production among non-OPEC members and then allocating production for members at levels that in theory would fulfill the residual demand. Asked if therefore OPEC production deliberations occurred "automatically," Moneef replied, "In practice, yes, but coordination and meetings remain necessary." He continued, "The market does not work on its own. When we want to increase production, we talk to our customers and call an OPEC meeting... There's a decision element to it." Asked which member countries had outlooks similar to the Saudis within OPEC. Moneef cited the GCC, as well as "Nigeria, sort of."

GOVERNOR SAYS INTERNATIONAL DEMAND
SHAPES SAUDI PRODUCTION AND PRICING

¶9. (C) Moneef said that in early 2008 when oil prices were soaring to record levels, demand was falling, and although current demand for oil has recovered somewhat from when it "tanked" later in 2008, it still remains "below 2008 levels." The OPEC Governor estimated that overall there had been a 3.2 mbpd decrease in demand. Chinese demand for oil was up significantly, with U.S. demand up somewhat less. Moneef said that U.S. requests had declined from mid-2008 to May 2009 but now were picking up. He said incremental demand was expected to mainly be from China, and to a lesser extent the U.S. but that European demand for Saudi crude was expected to drop.

¶10. (C) Moneef said the price formula that Saudi Aramco sent its customers had resulted in fewer requests (in Aramco parlance, "nominations") for Saudi oil. As a result, the OPEC governor said, the Saudis cut production 1.7 mbpd and the rest of the reduced demand had been absorbed by production cuts in other countries. Moneef asserted that Saudi Arabia does not typically "cut production" but instead raises prices to reduce demand. Aramco customers, he said, mainly want Arab Light oil, and often they are reluctant to buy the medium/heavy oil that the Saudis sell in addition to higher grade product. However, he said over the past two months, nominations had gotten "better, much better."

¶11. (C) Moneef predicted that the current 2.5 mbpd reduction in international demand would not persist, since it was due to the international financial crisis, which he said would be over in a few years. Chinese demand in particular would pick up soon. Nevertheless, in 10 or 15 years oil prices would return to record levels set last year. European production was declining. Maybe Abu Dhabi could increase somewhat, and the Iraqis even more. Russia would not increase production. Brazil would be able to increase production further by exploiting unconventional and deep-sea reserves.

¶12. (C) Asked whether it was true Saudi oil only cost $1-2 per barrel to produce (excluding indirect costs), Moneef emphasized that Aramco's costs had increased significantly in recent years. Operating costs were higher (labor, materials, and technology), and it was necessary to drill more development wells than before. The cost to bring each new barrel of oil to market, he said, had grown much more expensive. Development costs for the Shayba field in the Saudi Empty Quarter had cost $5K/barrel, which he estimated translated to $5 billion overall. In any case, Saudi

marginal production costs for petroleum differ by field. The Khurais field brought back on stream had been producing before and therefore production infrastructure already was in place. In contrast, the isolated Shayba field in the Kingdom's barren southeastern Empty Quarter had double or even triple the operating cost. Although capital costs were increasing, the OPEC governor acknowledged that Saudi "and someday Iraqi" oil still had the lowest production costs of any country.

¶13. (C) Asked what oil price Saudi Arabia assumed for planning, Moneef said the Finance Ministry and MinPet used separate numbers and for the latter the estimates varied over time. The 2004 MinPet price plan assumed $40/barrel, he said. Assumptions for the Manifa field were "higher," while the price for Shayba had been based on a conservative price of $15-18/barrel. Asked for Saudi oil's break even price, Moneef said that last year the Saudi budget assumption was $45/barrel, but that was based on the government running a "small" deficit. For a balanced budget, he said the price would need to be $55/barrel.

DECLINE RATES AND PEAK OIL

¶14. (C) Asked about the peak oil theory, Moneef said the decline rate for Saudi oil fields averaged 4% for the Kingdom, compared to 6-8% worldwide. He said "peak oil exists since petroleum is a depletable resource but the peak is not around the corner. Maybe 10-20 years from now. The UK has peaked already but most OPEC members have not. However, the important thing is it's not what's underground that counts for this. Investment is what matters. Also technology. Saudi assessments of their reserves are much higher than they used to be." He said Saudi Arabia used to think that its production would peak circa 1980-95 but this turned out to be "totally" inaccurate. He concluded that "the human factor" remained the most important resource in the oil business.

SPECULATION

¶15. (C) Moneef was asked for his views on the role speculation has played in "volatile" oil markets in recent years. The Saudi OPEC governor noted that the fundamentals currently did not support wild price swings, while the close correlation with both falling value of the dollar against other currencies and the international crisis affect on oil prices was prima facie evidence of a link between these factors. This happened along with a sharp increase in activity on energy markets. Oil has become an investment medium, he said. Moneef asserted that Saudi Arabia supports increased oversight of energy markets. The Saudi government was happy to see steps taken to study strengthening regulations, he said, and there always were going to be geopolitical factors as well as fears of peak oil. Now geopolitical fears were decreasing and/or have been factored into prices. Moneef said the Saudi view was that speculation represented approximately $40 of the overall oil price when it was at its height. Now that was lower. He said the Saudi government was following this issue closely and considers improving transparency and communication to be two of the best actions that could be taken to reduce speculative volatility.

¶16. (C) Asked what regulatory reforms the U.S. could institute in Moneef's view, to reduce impact of speculation on oil markets, he said transparency and cooperation amongst exchanges would be best. Perhaps strong position limits. He said the Saudis are watching discussion of this in the United States with great interest.

TECHNOLOGY, RENEWABLES, AND THE FUTURE

¶17. (C) On Saudi use of advanced technology in the oil sector, Moneef explained that from 1998 onwards, the Kingdom

began using horizontal drilling and now was injecting water and in some cases gas to increase production. He described how Saudi Arabia has been financing experiments in Canada on carbon capture and storage (CCS) on a project with Canada, Norway, the UK, and the Netherlands (called by others the "Four Kingdoms" project). Moneef said the Saudi government also was "looking for" a CCS project to undertake in Saudi Arabia. However, "We don't need it yet," he said. (NB: A senior International Oil Company executive posted to Riyadh told Econoff July 7 that the Saudis expected foreign firms to pay for any CCS projects implemented in the Kingdom.)

¶18. (C) Moneef said that Saudi Arabia remains interested in solar energy and the King Abdullah University of Science and Technology (KAUST) opening in September was being built with solar panels for "heating and other" purposes. However, the OPEC governor expressed skepticism about solar energy as a technology in general. Although Saudi Arabia was working hard to develop its use of the technology further, he said, the technology remains uneconomical for the Kingdom while fossil energy remains so plentiful and cheap domestically. Asked about the break-even point for renewable energy sources, Moneef said U.S. biofuel began to make sense only with oil costing $80-90/barrel. He estimated that oil costing $70 would make developing "some" tar sands and Brazil's deepwater oil reserves economical, "but not with oil at $40-50."

¶19. (SBU) Asked whether the Saudi oil business would be fundamentally the same 50 years from now, Moneef said in 20 years oil's share in the international energy mix will have declined. He said he saw unconventional oil production increasing significantly around the world by 10-15 years from today. Tar sands, heavy oil, and deep water production off the coasts of Brazil and West Africa will have begun to have a significant effect on the overall petroleum market, he said. In Saudi Arabia, gas liquids likely would play a much more significant role in the future. He estimated that 70% of future increments would be unconventional.

FINANCE

¶20. (C) Asked how Saudi Arabia financed energy projects, Moneef explained that upstream projects all were internally financed out of Aramco's budget. In contrast, downstream projects were 60% borrowed and 40% equity, with joint ventures organized differently. For example, he said, refinery construction projects typically were planned to have an internal rate of return of 14-15%. When the financial crisis hit, Saudi Aramco and MinPet had reexamined pending refinery investments, including the Total refinery project (in the Eastern Province) aimed at sending refined products to Asia, and the Conoco refinery project (along the Red Sea) that was to supply product to the Mediterranean and other points West. Luckily, he said, the previous $12 billion Conoco project's cost had dropped $2.4 billion. This mainly was due to reducing material costs as many regional projects had been cancelled. While the 2007 price of oil had averaged $70, he said, MinPet had assumed $50 for these projects. On the Fujian refinery project in China, he said, Saudi investment had led to a doubling of capacity at the refinery, and there eventually would be a tripling of capacity.

FUTURE OF SAUDI OIL SALES

¶21. (C) Asked if the Saudis would consider participating in commodity markets directly (instead of dealing with established customers via nominations), Moneef said this would not happen. Saudis view themselves as physical producers and sellers of petroleum, and if they sell directly into commodity markets, they will unduly affect prices and be blamed even more for high prices. He emphasized, "We don't want to get involved in that." Asked what was the "right price" of oil, Moneef said oil's price needs to provide sufficient revenue for producers and encourage investment, including in alternative energy sources. Therefore the Saudi

view was that it would be good for oil to be around $70. However, he reiterated that the Kingdom's main energy policy hinged not on price but on maintaining a 1.5 - 2 mbpd spare capacity, which he described as a mandate by the Kingdom's most senior policymakers for the past 30 years.

NOPEC

¶22. (C) Moneef mentioned the recurring U.S. draft NOPEC legislation as an example of an issue that would be considered by the Saudi economic deputies committee of the Saudi Supreme Economic Council (described septel). In addition to MinPet Assistant Minister for Petroleum Affairs HRH Prince Abdulaziz bin Salman, who is a regular Post interlocutor on this issue, Moneef said MFA Under Secretary for Economic and Cultural Affairs Yousef Saadon and Deputy Minister of Finance for Economic Affairs Hamad Al-Baz'y were key players. He also mentioned Abdulrahman Abdulkarim (counselor to Oil Minister Naimi, with rank equivalent to Deputy Minister) as a key player in NOPEC discussions.

¶23. (C) Moneef was asked how Saudis set compensation for energy sector personnel. Why not sharply increase salaries, and how were they set? Moneef said Aramco had faced significant employee attrition a few years ago, mainly to the financial sector. It updated its survey of "similar employers," looking at (among others) banks and the country's petrochemical giant SABIC. Aramco updated the survey, adjusted salaries, and now tries to "stay a little ahead" of other firms in terms of salaries. He joked that the financial sector no longer was luring away candidates (thanks to the financial crisis).

¶24. (U) Congressman Grayson did not have the opportunity to clear this telegram.
ERDMAN